ST 97-37
Tax Type: SALES TAX
Issue: Responsible Corp. Officer - Failure to File or Pay Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,	)	
v.	)	No.
	)	IBT
"JOHN DOE", as responsible officer of "XYZ" Corporation, Inc.,	)	NPL
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances: Lane Gensburg of Dale, Jacobs & Gensburg, for "John Doe"; John White, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter came to be heard following the timely protest of "John Doe" to the issuance of a Notice of Penalty Liability (#0000) by the Illinois Department of Revenue on May 13, 1993. At issue is the question whether the named respondent is personally liable under the former provisions of Ill. Rev. Stat. Ch. 120, Sec. 452 1/2[1] as a "responsible" corporate officer who willfully failed to file returns and pay taxes owed by the corporate entity known as "XYZ" Corporation, Inc., for the period of January, 1982, through and inclusive of December, 1985. Following a hearing and review of the

[1] As of January, 1994, this section was repealed and incorporated within the Uniform Penalty and Interest Act, 35 ILCS 735/3-7.

evidence of record, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

Procedural Issue (Service):

1. The Department's *prima facie* case and all jurisdictional elements associated therewith was established by the admission into evidence, without objection, of Notice of Penalty Liability #0000, issued against the person of "John Doe", on May 13, 1993 as the responsible officer of "XYZ" Corporation, Inc. ("XYZ"). (Dept. Ex. No. 1)

2. The issuance of this NPL succeeds a finding of liability against "XYZ", for unpaid Retailers' Occupation taxes on or about April 9, 1992, following a full administrative hearing. (Taxpayer Ex. No. 1; Department Ex. No. 2A)

3. No appeal was taken and no complaint was ever filed from the Department's finding against "XYZ" under the Applicable provisions of the Administrative Review Law. 735 ILCS 5/3-101 *et seq*.

4. A copy of the findings and recommendation of the administrative law judge ("ALJ") in that proceeding, along with proper notice of the right to appeal and the time limitations within which such appeal of the findings against the corporation could be taken, were served upon and received by "XYZ"'s counsel of record "some time in April of 1992". (Tr. pp. 49-52).

5. In addition to the ALJ's recommendation and findings, the Director of Revenue issued a final administrative decision which adopted the ultimate conclusions of liability made therein but made

additional findings of fact and conclusions of law on alternative premises. (Dept. Ex. No. 2A)

6. Due to some unexplained clerical error, the Director's final administrative decision was not received by "XYZ"'s counsel along with the ALJ's findings and recommendations. (Tr. pp. 51-53)

7. "XYZ"'s counsel was thereafter personally served with a copy of the ALJ's recommendation, the Director's final decision, a notice of decision advising counsel and/or the taxpayer of the right to file for administrative review, and a cover letter explaining the situation and allowing an additional 35 days in which to appeal due to the mix-up. (Tr. pp. 36-42). Said documents were handed to counsel and dated as of May 28, 1992. (Tr. p. 53).

8. The testimony of "Robert Doe", counsel to "XYZ", on the question of service and receipt of the ALJ recommendation, the Director's final decision and the notice given was both confused, inconsistent and not worthy of belief. Although he acknowledged receipt of the initial recommendation and notice (Tr. pp. 49-52), he later testified that he was never told orally or *in writing* of his right to appeal or the time limitations therein. (Tr. p. 64).

9. Although he had written notice as of April 9, 1992 that the recommendation of liability had been accepted by the Director and was appealable,[2] he (counsel) purportedly chose not to do so on the

[2] The Notice of Decision admittedly received by Mr. "Robert Doe" on April 9, 1992, stated the following: "YOU ARE HEREBY NOTIFIED that the attached recommended decision of the Administrative Hearings Division of the Illinois Department of Revenue in the above entitled cause has been accepted by the Director as dispositive of the issues therein. This recommendation is now a final administrative decision and establishes your rights or responsibilities regarding the subject matter of the hearing. Should this decision be adverse to you, you may pursue your rights to administrative review by filing a complaint in the circuit court under the requirements of Ill. Rev. Stat. Ch. 110, Sec, 3-101 et. seq., within 35 days of the date of mailing of this notice." (Emphasis added) On occasions as here, when a "Director's decision" was written which supplemented the ALJ recommendation and came to the same ultimate conclusion, it was and is the practice of the office to include both the ALJ

belief that the decision was not final until the Director's decision was issued. (Tr. pp. 62-63). However, he did not even know of the existence of a "final" decision of the Director until some time late in May, 1992, well after the time for appeal would have ordinarily expired.[3] (Tr. pp. 49-52; 56-58)

10. Mr. "Robert Doe" also claimed that he did not abide by the language of the Notice of Decision because "he did not trust it in that he thought it was flawed". (Tr. pp. 64-65)

11. No appeal was ever taken and no complaint for administrative review was ever filed from the final administrative decision of the Director issued and served upon taxpayer's counsel on May 28, 1992. (Dept. Ex. No. 3; Admission of Facts #1; Tr. pp. 60-61)

Substantive Issue:(Willful Failure)

12. Respondent "John Doe" was an educated person, having received his college degree in accounting and attaining certification as a Certified Public Accountant, which he maintained in active status until August, 1984. (Tr. p 147; Dept. Ex. No. 4)

13. Prior to his involvement with "XYZ", "John Doe" started and was a principal in at least 10 other companies or corporations dealing with medical management receivables. (Tr. pp. 149-54). During the period of "XYZ"'s incorporation, he was directly involved with two other businesses, *viz*. "ABC" Corp. of America and "PDQ" Corp. (Tr. p 203)

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recommendation and the Director's decision in the package of documents served upon the taxpayer. (See Tr. pp. 27-28)

[3] The credibility of the testimony of "Robert Doe" is also suspect due to the close familial relationship (father -son) he has with the respondent, "John Doe".

14. “John Doe” was the incorporator of “XYZ” in the State of Illinois. (Dept. Ex. No. 3; Admission of Facts #3)

15. “John Doe” served in the capacity of President of “XYZ” at all times during its corporate existence. (Dept. Ex. No. 3; Admission of Facts #2)

16. “John Doe” personally prepared and signed corporate tax returns for “XYZ” during the audit period. (Dept. Ex. No. 3; Admission of Facts #6)

17. “John Doe” had the authority to hire and fire all persons employed by “XYZ”. (Tr. p. 289; Dept. Ex. No. 8)

18. Although “John Doe” maintained possession of some of “XYZ”’s books and records during some part of the audit period, including the general ledger and credit memos he personally prepared for “XYZ”, and the copies of customer invoices which he moved from “XYZ”’s “Anywhere” Street facility to his “Somewhere” office in June 1985, he never turned over these books and records to the Department despite several requests for them. (Dept. Ex. No. 3; Admission of Fact #5; Tr. pp. 233-36; Tr. p. 232; Dept. Ex. No. 2A, at 9-10 & n.3.)

19. “John Doe” personally instructed “XYZ”’s employees how to prepare invoices for the corporation and how to batch and forward the invoices to his “Somewhere”, Illinois office for entry into sales and cash receipts journals. (Tr. pp. 185-86, 289-96, 334-35)

20. “John Doe” knew that the invoices issued by “XYZ” during the audit period listed charges under the headings of “Tax” or “sales tax” or “tx”. (Dept. Ex. No. 3; Admission of Facts #9; Tr. p. 214 - admission of counsel)

21. Irrespective of whether Illinois taxes were rightfully due, "John Doe" knew that "XYZ" collected money from its customers on its sales of tangible personal property, for charges included in the corporation's invoices under headings such as "sales tax". Notwithstanding, no returns were filed by him with the Department of Revenue including or otherwise regarding such sales. Dept. Ex. No. 3; Admission of Facts #11;[4] Dept. Ex. No. 2A at 5)

22. Throughout the audit period, gross receipts received by a retailer from sales of tangible personal property, regardless of whether those sales were exempt or otherwise free from tax, were nevertheless required to be reported on returns filed with the Department and then deducted from the retailer's gross receipts. (See Ill. Rev. Stat. Ch. 120, Sec. 442 (1981);[5] 86 Ill. Admin. Code, Ch. I, Sec. 130.310(d); 86 Ill. Admin. Code, Ch. I, Sec. 130.501 (1979).

23. Despite the knowledge that taxes were in fact collected from customers of "XYZ" for charges included in its invoices under headings such as "sales tax", "John Doe" failed to remit the full amount of those collections to the Department of Revenue. (Dept. Ex. No. 3; Admission of Facts #12)

24. Instead of filing returns and remitting the moneys collected by "XYZ" from its customers after he knew of such collections, "John Doe" instead prepared and claimed to have issued credit memoranda which would be used to "reduce a customer debt to "XYZ", or to offset a customer's cost of future purchases of tangible

[4] The failure of "John Doe" to respond to the portion of the Request to Admit on this question acts as an admission thereof. See Supreme Court Rule 216 and Department of Revenue Hearing Rule 200.125(b)(1)(A).
[5] This provision is now cited as 35 ILCS 120/2

personal property from “XYZ””. (Dept. Ex. No. 3; Admission of Facts #14)

25. The credit memoranda “John Doe” prepared did not, on their face, reflect unconditional repayments of the taxes “XYZ” collected from its customers, but instead imposed such conditions and restrictions on their use as to render them useless. (Taxpayer Ex. No. 9; Dept. Ex. No. 2A)

26. At or near the end of “XYZ”’s corporate existence and on or about August 30, 1985, “John Doe” started and incorporated another Illinois business known by the name of “XXXX”. He additionally served as “XXXX”’s principal shareholder and president. (Dept. Ex. No. 5; Tr. pp. 265-66)

27. Soon after “XXXX”’s incorporation, “John Doe” personally endeavored to transfer the assets of “XYZ” to “XXXX”. (Tr. pp. 265-66, 280-82, 355-57). These assets included the entirety of “XYZ”’s inventory, accounts receivable, equipment, furniture and fixtures. (Tr. pp. 280, 355)

28. Despite the explicit requirement to do so as provided by Ill. Rev. Stat. Ch. 120, Sec. 444j (1985),[6] and attendant penalties thereon, “John Doe” never notified the Department of Revenue of the transfer of “XYZ”’s inventory to “XXXX”. (Tr. pp. 349-50).

29. Through such transfer of assets, “John Doe” personally ensured that “XYZ” would have no means by which to refund to its customers nor to pay over to the Department, the taxes previously collected.

30. “John Doe” placed further restrictions and impediments in the way of the customers of “XYZ” and the Department of Revenue by

involuntarily dissolving this corporation by the non-payment of its annual franchise tax. (Dept. Ex. No. 4; Tr. p. 283)

31. The testimony of "John Doe", throughout the hearing, was contradictory, suspect and unreliable. For example:

a) He first testified that he acquired the assets of an Indiana Corporation also known as ""XYZ"" Corporation, Inc., but later stated that he acquired nothing from that corporation. (Compare Tr. pp. 156-9 and Tr. pp. 280-81);

b) He first testified that "XXXX" purchased the assets of "XYZ" (Illinois) and subsequently testified that he acquired the assets as a secured creditor and personally transferred those assets to "XXXX". (Compare Tr. pp. 265-6 and Tr. pp. 355-57);

c) He first responded to the Department's Request to Admit Facts by denying that "XYZ" erroneously charged Illinois tax to its customers and during the hearing admitted that such charges had been made. (Compare Dept. Ex. No. 3; Admission of Facts #s 11, 13 and Tr. pp. 302-04)

d) He originally professed "shock" at the discovery that taxes were being charged to "XYZ"'s customers on the sale of tangible personal property, but had previously signed an agreement in February of 1985 to pay "Someone" a percentage of "XYZ"'s corporate sales, which were defined as gross sales, less shipping expenses, *taxes* and dealer's and/or distributors commissions and/or discounts. (emphasis added) (Compare Tr. pp. 231, 300 and Dept. Ex. No. 8; Tr. p. 330)

32. "John Doe"' professed "reliance" on the advice of his father, "Robert Doe", and a friend, "Anyname", in 1981, that "XYZ" would incur no tax liability for Illinois ROT because the items sold were supposedly exempt as "medical appliances" is not persuasive and there are no reasonable grounds therefor.[7] (See Tr. pp. 103-4, 120)

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[6] This provision is now cited as 35 ILCS 120/4(j)

[7] Not only do the items of tangible personal property which "XYZ" sold not qualify as medical appliances in and of themselves (i.e. blood testing equipment does not "correct or otherwise substitute for a functioning part of the body), but the terms of the statute imposed a 3% (1980) and subsequently a 2% (1981-83) tax on such appliances at the time of "XYZ"'s incorporation and during the majority of the audit period. It was not until January 1, 1984 that the tax on medical appliances was reduced to 0%. Therefore, the supposed "research" on this issue which was performed by "Anyname", a certified public accountant and "Robert Doe", an attorney in 1981 could not have

33. "John Doe"'s professed "reliance" on the advice of his father, "Robert Doe" and a friend, "Anyname", in 1981, that "XYZ" would incur no tax liability for Illinois ROT because the items sold were supposedly exempt as being in "interstate commerce" is not persuasive and there are no reasonable grounds therefor.[8] All of the transactions at issue were made by an Illinois corporation, from a location in Illinois, to customers in Illinois. (Dept. Ex. No. 2A)

Conclusions of Law:

Service Issue.

The Administrative Procedure Act, 5 ILCS 100/10-50 provides as follows in regard to final decisions and orders of an administrative agency:

> (a) A final decision or order adverse to a party (other than the agency) in a contested case shall be in writing or stated in the record. A final decision shall include findings of fact and conclusions of law, separately stated. Finding of fact, if set forth in statutory language, shall be accompanied by a concise and explicit statement of the underlying facts supporting the findings... Parties or their agents appointed to receive service of process shall be notified either personally or by registered or certified mail of any decision or order...
>
> (b) All agency orders shall specify whether they are final and subject to the Administrative Review Law.

As part of his defense to the matter brought under the Notice of Penalty Liability, "John Doe", through his counsel, attempts to challenge the service of the Department's decision which originally found liability to exist against the corporate entity. In doing so, it is claimed, through the testimony of "John Doe"'s father, "Robert

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examined the statute in question. (See Ill Rev. Stat. Ch. 120, Sec. 441 (1981)). It is also noted that "John Doe" does not challenge the finding of the Department that the items sold by "XYZ" were not medical appliances, only that he had a reasonable belief that they were at the time. (See Tr. pp. 161-62).

Doe", then counsel of record for "XYZ", that he either did not timely receive any final decision, or alternatively he was not given notice of his right to appeal.

In examining this issue, I make careful note of the fact that during his testimony on the matter, "Robert Doe" was inconsistent as to the sequence of events which transpired and his answers made little sense in light of what present counsel was trying to claim.

Under the facts established herein, there is no dispute that "Robert Doe", as counsel of record in the administrative proceeding known as The Department of Revenue v. "XYZ" Corporation, Inc., was served with a copy of the ALJ's recommended decision to impose full liability on the company for unpaid Retailers' Occupation taxes for the audit years 1982 through 1985. That recommended decision was served by process of certified mail and delivered on or about April 9, 1992. Equally undisputed is the fact that "Robert Doe" simultaneously received a notice that said the recommendation had been accepted by the Director and declared it to be final and appealable under the provisions of the Administrative Review Law. At that point in time, the taxpayer, "XYZ", had 35 days in which to appeal the decision of the Department of Revenue by filing a complaint in the circuit court, challenging the propriety of the findings and conclusions made. That was not done.

Apparently absent from the materials served upon said counsel, was a copy of a final administrative decision, written under the name and on behalf of the Director of the agency, which supplemented the findings of the ALJ and came to the same conclusion of liability.

[8] At the time such "advice" was given by "Anyname", he had no idea nor any personal knowledge of how "XYZ"

When this omission was discovered, counsel sought and was served personally with a copy of the final decision, which was dated May 28,1992. It is at this point that the sequence of event diverges as presented by the witnesses.

"Robert Doe" relates through his testimony that he did not appeal what fully appeared to be and what was labeled as a final administrative decision on April 9, 1992, either because he felt it to be "flawed"[9] or because he did not consider it to be final until the Director's decision was issued and served.[10] Either reason is unacceptable.

What is inherently suspect in counsel's rationale, is that when he was served with the initial recommendation and notice on April 9, 1992, and purportedly did not receive a copy of the final (Director's) decision along with it, he could not have known of its existence.[11] His own testimony indicates that he did not discover that there was a "final" Director's decision until a chance meeting with the presiding ALJ sometime in mid to late May of 1992. As such, the absence of such a decision from the documents served upon him cannot possibly serve as a basis for not filing a complaint for administrative review of the recommendation of the ALJ. For all he knew, what was received on April 9, 1992 constituted the extent of the Department's action in relation to the case, i.e. the recommendation, statement adopting the recommendation as final and a notice of the right to appeal under the terms of the Administrative Review Law.

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conducted its business nor from what location any sales were being made. See Tr. p. 106.

[9] See finding of Fact No. 10, *supra*.

[10] See finding of Fact No. 9, *supra.*

Conversely, his alternative statement that he could have learned of the Director's decision "from the ALJ at the conclusion of the hearing" is, by its very nature incapable of belief. At the time the hearing was concluded, the ALJ recommendation was not even written, so no supplemental decision could have existed at that time or even have been reasonably contemplated by the ALJ. Accordingly, I reject counsel's testimony as to the reasons why no appeal was taken from the decision served on April 9, 1992.

When the purported omission was at last discovered, a complete package, consisting of the ALJ recommendation, the Director's decision, another copy of the notice and an explanatory letter were personally handed to "Robert Doe" on May 28, 1992.[12] Although he testified that he received nothing more than a copy of the Director's final decision, I find the testimony of Richard Ryan, at that time serving as Chief of Administrative Hearings, as to the sequence of events, to be more credible based upon my personal knowledge of standard office practices.[13]

Even assuming, *arguendo*, "Robert Doe" had received nothing other that the Director's decision, on May 28, 1992, it unarguably contained findings of fact and conclusions of law, and was clearly marked as a "Final Administrative Decision". Those points alone satisfy at least part of the requirements imposed by the APA, and stands as legally sufficient to have alerted him to the fact that the

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[11] See finding of Fact No. 9, *supra*.

[12] See Finding of Fact No. 7, *supra*.

[13] On infrequent occasions where similar omissions due to clerical errors have occurred, both previous and subsequent to this event, the Department has consistently allowed taxpayers an additional 35 days in which to appeal as though original service had been made at that time. There would be no reason here to believe that any deviation from that standard practice and procedure had taken place. This is consistent with the fact that Mr. Ryan dated the copy of the final decision given to "Robert Doe" as to the time and day of personal service.

decision was now appealable. The only question remaining then is whether the Department substantially complied with the last half of section (b) of 5 ILCS 100/10-50 by advising taxpayer's counsel that the decision was (still) subject to administrative review.

In analyzing this aspect of the service issue, I again take note of fact that "Robert Doe" did receive a notice of decision which contained a ***written*** advisory of the right to appeal under the Administrative Review Law (the "ARL") on April 9, 1992. That fact, coupled with his expressed rationale that he did not take such appeal because he understood it was not final until issuance of the director's decision, raises the fair inference that he knew or should have known of the right of appeal and applicability of the ARL when served with the Director's decision on May 28, 1992. Indeed, to accept his version of the transaction, he was specifically waiting for the final decision so that he could purportedly act on it. In essence he knew of the applicability of the ARL because he had already been advised in writing to that effect. The fact that there may have been a separation in time (again assuming "Robert Doe"'s version), between the notification and the actual service of the document which could be appealed should not act to negate the service and legal applications necessary.

I therefore conclude the requirements of the Administrative Procedure Act, specifically 35 ILCS 100/10-50(a) and (b) have been fulfilled, that "Robert Doe" as counsel for "XYZ" had actual and constructive notice of his right to appeal and that both service and written notice of the Final Administrative Decision were legally sufficient.

Willfulness

The Department of Revenue brings the substantive portion of this proceeding under the auspices of Section 452 1/2 of the Retailers' Occupation Tax Act ("ROTA"), which, during the period in question, read in applicable part as follows:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax evaded, including interest and penalties thereon; and the personal liability of such officer or employee as provided herein shall survive the dissolution of the corporation... (Ill. Rev. Stat. Ch. 120, Sec. 452 1/2 (1985)[14]

Respondent "John Doe", does not appear to raise any legitimate contention to the charge that he was *the* responsible officer for "XYZ". Instead, his defense to this action lies primarily within the argument that he did not act willfully as the responsible officer in failing to file the necessary returns or pay the taxes due by the corporation. However, for the purposes of this record, I specifically conclude that "John Doe" was a "responsible" corporate officer based in part upon the following facts:

> a) He incorporated "XYZ". (Admission of Facts #3)
> b) He personally prepared and applied for an ROT registration number for the corporation. (Dept. Ex. No. 7; Tr. pp. 319-25)
> c) He was at all times "XYZ"'s President and chief financial officer. (Admission of Facts #2)
> d) He prepared and maintained some corporate books and records. (Admission of Facts #3)
> e) He personally prepared and signed corporate returns during the audit period. (Admission of Facts #6)
> f) He had signature authority and wrote checks for the corporation. (Tr. pp. 201-02)

[14] This provision is now contained under the Uniform Penalty and Interest Act, 35 ILCS 735/3-7 (1994)

g) He had the authority to hire and fire employees of the corporation. (Tr. p. 289; Dept. Ex. No. 8)
h) He directed the employees in the performance of their duties, including the preparation of invoices and the language to be used on those invoices. (Tr. pp. 185-86; 289-96; 334-35)

The significant control and authority exercised by "John Doe" over the affairs of "XYZ" prior to, during and after the audit period are more than enough to determine that he was indeed a "responsible" corporate officer as contemplated by the Act.[15]

Having thus established his responsible position within "XYZ", the only remaining question to be determined here is whether "John Doe" acted willfully in failing to file returns or pay taxes due from the corporation during the time period involved. In addressing this question, respondent seeks to avoid liability by claiming that he had a reasonable belief that taxes were not due. That belief was evidently premised upon advice given him that "XYZ" would incur no Illinois tax because the sales of tangible personal property made by it were exempt, either because the items sold were medical appliances or that sales were in interstate commerce. Notwithstanding the fact that any such belief as professed here is largely irrelevant to the issue of personal liability,[16] I cannot conclude from the evidence

[15] The case of *Silverberg v. United States*, 524 F. Supp. 744 at 747, outlined five relevant factors in determining the responsibility of a corporate officer in order to impose a 100% penalty under Sec. 6672 of the Internal Revenue Code. (26 U.S.C. Sec. 6672). These factors are: a) the identity of the officer or employee; b) the extent of the duties engaged; c) to what extent is the person authorized to disburse funds; d) the identity of the individual over those with financial control; e) the power of the individual to employ and/or dismiss persons important to remitting tax moneys. The language of Section Ill. Rev. Stat. Ch. 120, Sec. 452 1/2 was based upon Sec. 6672 and is virtually identical to it. See *Department of Revenue v. Heartland Investments, Inc*., 106 Ill. 2d 19, 28 (1985). (See also *Department of Revenue v. Roman S. Dombrowski Enterprises, Inc.*, 202 Ill. App. 3d 1050 (1990), where the court upheld the penalty against a corporate officer who had a substantial role in the preparation of corporate returns and who failed to make payments during the audit period.

[16] Any "belief" held by "John Doe" as to the taxable nature of the business conducted by "XYZ" is irrelevant to his defense because the evidence of record, as well as his own admission, conclusively show that taxes were nevertheless collected by the corporation and not remitted. This aspect of the case will be discussed *infra*.

presented that any such belief was reasonable or that it would otherwise protect him from the imposition of a penalty here.

Respondent avers that no personal liability can attach under the facts of this case due to his claimed ignorance that taxes were required to be collected. (Tr. p. 84). Citing the case of the Department of Revenue v. Corrosion Systems, 185 Ill. App. 3d 580, 541 N.E. 2d 858 (4th Dist. 1989), it is proffered that a principal component of willfulness is a showing that the individual cited ***knew*** that tax was due. It therefore necessarily follows that in the absence of such a showing, no personal liability can legally be imposed.

While it is true that "willfulness" within the ambit of Section 452 1/2 has been defined as a "knowing, voluntary and intentional act",[17] what is ignored in respondent's argument is that the courts have generally not allowed corporate officials and employees to hide behind a wall of self-created and blissful ignorance in examining the issue of willfulness vis-à-vis their responsibilities. While the court in Corrosion Systems, ***supra***, did exonerate the corporate official held to be responsible, that case can be distinguished from the present facts. In that case, the principal officer had no actual knowledge nor any reason to believe that taxes were due and unlike here, did not collect any from the business customers. Even the decision in Corrosion recognized such a difference in circumstance as potentially affecting the outcome.

More specifically, several courts have gone beyond the "knowing, voluntary and intentional" threshold and have imposed personal

[17] See *Department of Revenue v. Joseph R. Bublick & Sons, Inc*., 68 Ill. 2d 568, 576 (1977).

liability where, alternatively, there has been a showing of a reckless disregard for obvious or known risks. Carl E. Branson v. Department of Revenue, 168 Ill. 2d 247 (1995). This has sometimes been described as the "gross negligence" standard where an officer "clearly ought to have known that there was a grave risk that... taxes were not being paid and [they] were in a position to find out for certain easily". See Wright v. United States, 809 F. 2d 425 at 427 (7th Circ. 1987); Ruth v. United States, 823 F. 2d 1091 at 1094-95 (7th Circ. 1987); Brown v. United States, 552 F. Supp. 662 at 664 (ND Ill. 1982).

Taking that standard and applying it to the circumstances before me, I am reluctant to accept that any rational person could conclude the actions of "John Doe" in creating and incorporating "XYZ" and subsequently running it, were not "grossly negligent" with respect to ascertaining the proper tax responsibilities of this corporation.

Initially, we must look to the fact that "John Doe", at the time of "XYZ"'s incorporation, was not an unsophisticated person and was certainly not a naive stranger to the world of taxation. To the contrary, he was a *trained* professional, having attained a degree in accounting, achieving licensure as a certified public accountant and possessing the experience of having started and operated at least 10 other businesses in the same general lines of endeavor. (Dept. Ex. No. 4)

In view of that level of education, training and experience, what steps then did "John Doe" take to positively ascertain what tax liabilities might pertain to "XYZ"? Rather than consult a tax professional with all pertinent facts at his disposal, or otherwise

asking the Department of Revenue itself for a ruling, he simply sought the advice of a friend (who just happened to be an accountant) during a children's baseball game. However, the friend, "Anyname", evidently rendered such advice without any knowledge of or meaningful inquiry about how "XYZ" conducted or intended to conduct its business. (Tr. p. 106). Other than this casual conversation, the only other step taken by respondent in this vein was to ask his own father.

His father, "Robert Doe", had virtually no experience in sales tax matters of any kind and from the import of the testimony given at hearing consulted only remotely associated and vague references (e.g. Illinois Digest) when conducting his "research" into the matter. He evidently did not even examine the pertinent statute involved or any associated regulations when giving his son an opinion on the question. (Tr. p. 120) Even a cursory perusal of the ROTA, as it applied to medical appliances at the time, would have alerted all but the most uneducated that a (reduced) tax was due on the sale of these items.[18] Yet an attorney ("Robert Doe") and two CPA's ("John Doe" and "Anyname") never once attempted to or even thought of looking at the statute or departmental regulations, which should be the basic starting point of any tax inquiry, especially by persons schooled or partially schooled in the law as these individuals had to be.[19]

In the seminal case of Carl E. Branson v. Department of Revenue, 168 Ill. 2d 247 (1985), the Illinois Supreme Court held that:

> ...lack of willfulness is not proved simply by denying conscious awareness of a tax deficiency that could have

[18] This is, of course, assuming that they could qualify as medical appliances at all.

[19] It is noted here that the failure of "Robert Doe" to have undertaken any competent research on the issue of "XYZ"'s tax responsibilities also affects his credibility as a witness for his son.

> been easily investigated by an inspection of corporate records. *Id*. at 267.

Using that same analogy, I suggest that the absence of willfulness cannot be maintained through a plea of ignorance when no reasonable effort was expended to conclusively determine what the tax ramifications of any business undertaking might be.

Here, the evidence unequivocally demonstrates that no real effort was undertaken by "John Doe" to actually determine the responsibilities of "XYZ" for the filing of returns and/or the payment of taxes to the State of Illinois based upon its business practices. Simply asking the opinion of a friend under decidedly casual and certainly distracting circumstances, and without full disclosure of facts, is not a reliable business act. To merely rely on one's father, who admittedly has no experience or level of expertise in the field, is just being foolhardy. While these less than basic inquiries might possibly be understood coming from someone who is unschooled, ignorant or perhaps simply a neophyte in the world of business, taxes and all that may go along with it, they cannot reach the level of intelligent or responsible investigation on the part of someone who is trained, educated, experienced and familiar with the issues and problems at hand.

In all, the attempts by "John Doe" to ascertain the real tax obligations of his company through serious investigation and inquiry are conspicuously non-existent in this record. His actions then (or non-action, as the case may be) constitute a reckless disregard of obvious or known risks regarding the potential tax consequences of operating "XYZ", as a matter of law. As president and major domo of the company, he was in the best position to find out for certain

through competent inquiry what taxes, if any, would apply. He did not and as a result, was grossly negligent in failing to do so. As such, any beliefs which may have been held by "John Doe" were founded on gossamer and decidedly unreasonable in scope, if indeed they were actually held at all. Therefore, they cannot form the basis for any defense premised on a supposed lack of knowledge. Claiming ignorance under the circumstances extant, does not provide "John Doe" with any escape route from holding him personally responsible for the taxes remaining unpaid.

Notwithstanding the foregoing discussion, it is of little consequence within this proceeding as to what "John Doe" may or may not have "believed" or whether that belief was reasonable. What remains as definitive in the context of "XYZ"'s business operations during the audit period is that taxes were in fact collected from customers on the sale of tangible personal property and not subsequently remitted nor even reported to the State. (Dept. Ex. No. 3, Admission of Facts #12) Once such circumstance occurred, and particularly after respondent became aware of it, the controversy over his purported beliefs or even whether the sales actually were exempt, becomes moot.

Reflecting the intent, terms and mandate of the Retailers' Occupation Tax Act, Ill. Rev. Stat. Ch. 120, Sec. 441, et seq. (1983),[20] the Department's regulatory provisions require that:

> a) Except as provided in Sections 130.502, 130.510 and 130.2045, on or before the twentieth day of each calendar month, every person engaged in the business of selling tangible personal property at retail in this State during the preceding calendar month *shall file a return* with the Department for such preceding month, stating the name of

[20] Now cited as 35 ILCS 120/1, et seq.

> the seller, his residence address and the address of his principal place of business, and the address of the principal place of business (if that is a different address) from which he engaged in the business of selling tangible personal property at retail in this State.
>
> b) In addition, *the return shall disclose* the following:
>
> *Total receipts for the Month from sales of Tangible Personal Property and Services*...
>
> 2) Deductions Allowed by Law
>
> The taxpayer should include in his total receipts, but should deduct before computing the amount of tax:
>
> A) Taxes collected from sales of the following:
>
> iii) food, drugs and *medical appliances* retail sales.
> 86 Ill. Admin. Code Ch. I, Sec. 130.501 (emphasis supplied).

It is thus manifest that all Illinois retailers, of which "XYZ" was one, must file regular monthly returns with the Department of Revenue and report *total* receipts from sales of tangible personal property. The law nowhere allows a retailer to skip the filing of returns and the reporting of receipts on the belief, however sincere, that those receipts are not taxable. To the contrary, a retailer is required to report receipts on those sales and take a deduction for them. Despite the imposition and requirements of these statute and regulatory mandates, "XYZ" and "John Doe", as its principal corporate officer, failed to file such returns and report the receipts on the sales of tangible personal property for the audit period.

The ROTA goes on to provide:

> <u>If a seller collects an amount</u> (however designated) that purports to reimburse the seller for retailers' occupation tax liability <u>measured by receipts that are not subject to retailers' occupation tax, or</u> if a seller, in collecting an amount (however designated) that purports to reimburse the seller for retailers' occupation tax liability measured by receipts that are subject to tax under this

> Act, collects more from the purchaser than the seller's retailer's occupation tax liability on the transaction, the purchaser shall have a legal right to claim a refund of that amount from the seller. If, however, that amounts not refunded to the purchaser for any reason, the seller is liable to pay that amount to the Department... Ill. Rev. Stat. Ch. 120, Sec. 441 (1983)[21] (emphasis added)

This provision makes it clear that in situations, as here, where a company collects a tax from a customer which is not otherwise due or which may be more than what is legally due, the retailer must either refund the moneys collected to the purchaser(s) or else remit the funds to the Department. Failing that, the retailer becomes liable for the amount collected. Despite such requirement, "XYZ" collected tax on its sales of tangible personal property for a period of years and neither refunded those taxes to its customers nor remitted them to the Department.

Respondent testified he first learned of the taxes being collected in June of 1985. However, as the president of the company and being intimately involved in its sale, I find it difficult to believe he never once examined nor took a close look at customer invoices which showed a distinct "tax" or "TX" as an integral and identifiable part thereof. This story becomes even more suspect when considering the fact that the invoices were sent to "John Doe" at his office in "Somewhere", Illinois for entry into sales and cash receipt journals. (Tr. pp. 185-6, 289-96, 334-35) Nevertheless, once the problem was discovered no remedial action as required by the statute was undertaken by him in compliance with the law.

"John Doe" attempts to evoke protection for himself by claiming that credit memoranda were issued by him in response to the discovery that taxes had been (erroneously) collected by "XYZ". He also raises

[21] Now cited as 35 ILCS 120/2-40

the fact that he immediately changed the invoices to reflect a "surcharge", instead of a tax.[22] (Tr. p. 249; Taxpayer Ex. No. 10) This defense, however, is unsound due to several very glaring problems and omissions.

First, it must be noted that respondent has never produced any sort of documentary evidence that the purported credit memoranda were actually delivered to the customers of "XYZ". Other than oral testimony of their mailing, neither the record of the original hearing on the corporate liability nor the one produced here contain a single element of proof of actual delivery of these items. Moreover there is not even one instance mentioned or disclosed of any customer having redeemed or otherwise utilized the so-called credit instruments which may have been issued. Respondent had over 3 full years between the decision on the corporate liability and his own hearing to procure evidence corroborating or otherwise lending support to his position, but produced absolutely none.

Second, the credit memos prepared by "John Doe" were not really refunds as required by the Act. Instead, as admitted on the record here (Admission of Facts #14), he imposed conditions and restrictions on them which limited their use to reduction of a customer debt or to offset future purchases from "XYZ". (Dept. Ex. No. 3). Even under these inappropriate and impermissible standards, no provision at all was made for customers who may have had no debt to "XYZ" or who may have anticipated no further transactions with that company or any successor to it.

[22] I find it very curious that respondent would believe simply changing the designation "sales tax" to "surcharge" on an invoice, without any evidence of a commensurate change in rate would make a legal difference. Since it is

Third, as noted in the director's decision dealing with the corporate liability (Dept. Ex. No 2A), by the time "John Doe" issued the credit memos (again assuming they were in fact issued), "XYZ" was essentially out of business and making no further sales. Any distribution of credit memoranda under such circumstance then, is essentially and effectually a meaningless act.[23]

In the case of Central Illinois Light Co. v. Department of Revenue, 117 Ill. App. 3d 911, 916, 453 N.E. 2d 1167, 1170 (3d Dist. 1983), the appellate court held that in order to avoid unjust enrichment and a consequent liability to the Department under Section 441, a taxpayer must *unconditionally* repay the taxes collected to its customers or suppliers. In light of such requirement, it can only be concluded that the instruments issued by "John Doe" were not repayments to customers at all. In fact, they amounted to nothing more than worthless paper. They were uniformly unredeemable and unusable. Accordingly, "XYZ", and "John Doe" on its behalf, did not comply with the provisions of Ill. Rev. Stat. Ch. 120, Sec. 441. The taxes and other sums collected by the corporation from its customers remain due and owing.

The willful aspect of these transactions is exacerbated by the additional fact that during the time immediately following the "discovery" of taxes collected by "XYZ", "John Doe" undertook to transfer the assets of "XYZ" to another corporation, known as "XXXX". (Tr. pp. 355-57). As a secured creditor of "XYZ", "John Doe"

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admitted that the amounts designated were taxes, giving it a different name or description does not alter the reality of what it is, particularly if the "surcharge" exactly matches the applicable tax rate on the amount of the sale.

[23] Although "John Doe" testified (Tr. pp. 265-66) that the credit memos sent to customers of "XYZ" were "honored" by another corporation, "XXXX", there is absolutely no documentary or other corroborative evidence of

personally took the collateralized assets and transferred them to "XXXX" in August, 1985, thereby functionally ending the existence and operation of "XYZ". "XYZ" was shortly thereafter dissolved involuntarily by the Secretary of State for failure to pay its annual franchise tax. (Dept. Ex. No. 4.1). "John Doe" was the incorporator, president and principal stockholder of "XXXX". (Tr. p. 281).

By the record presented and the evidence admitted, I conclude that "John Doe" acted willfully in attempting to evade or defeat the payment of taxes due. This conclusion is founded both through the gross negligence displayed and by the insincere, ineffectual and useless attempts by him to remedy the situation once problems were discovered. At all times during the corporate existence of "XYZ", "John Doe" knew or *should have known* that a grave risk existed that taxes were not being paid on the sales of tangible personal property and took no meaningful or otherwise legitimate steps to ensure compliance with the law. This is especially true after June of 1985. I also specifically concur with the Director of Revenue, as noted in his supplemental decision concerning the corporate liability (Dept. Ex. No. 2A) that "John Doe" is not credible, being inconsistent, contradictory and generally unbelievable in the testimony given.

Having found and concluded that respondent acted willfully in failing to file requisite returns and pay taxes due to the Department, he is therefore personally liable under the provisions of Ill. Rev. Stat. Ch. 120, Sec. 452 1/2 (1991) for the unpaid taxes owed by "XYZ" Corporation, Inc.

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this either. Even if they were so honored, the documents are still no more a refund of collected taxes by "XXXX"

It is recommended that Notice of Penalty Liability, No (0000) be upheld in its entirety and a final assessment be issued against the person of “John Doe” in accord therewith.

Daniel D. Mangiamele
Administrative Law Judge

10/17/97

than they were by “XYZ”, due to the restrictions imposed.